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MARKET OVERVIEW

# INDUSTRIAL SPACE

BULGARIA | Q2 2011

## Inventory & Pipeline

The total stock of modern industrial space in Sofia increased with 1.40%, reaching 2.097 million m<sup>2</sup> in Q2 2011. We estimate that the new deliveries are ca. 28,996 m<sup>2</sup> – Dhollandia finalized their facility near Grigerov village, Elin Pelin municipality, Jessica finished their distribution facility in Elin Pelin and Ingredia Bild moved in the new building in Kazichene. A couple of smaller buildings occupied by SMEs were also delivered in Q2 2011.

The construction starts are ca. 10,796 m<sup>2</sup> in Q2 2011. This is one of the lowest level of the construction starts in comparison to the previous years with only a few projects breaking ground. Three years after the beginning of the crisis the construction activity in the industrial and logistic sector is bottoming.

An interestingly significant share of the construction starts belongs to a speculative project in Northern Sofia, where a local investor will redevelop a brownfield plot. This is a bold move which might be rewarded if the economy starts improving in the following quarters.

## Demand

Demand remains weak. The net absorption for Q2 2011 reached 24,956 m<sup>2</sup> – a slight increase from 23,118 m<sup>2</sup> in the previous quarter, whereas the figure for Q4 2010 was ca. 32,408 m<sup>2</sup>. If this trend continues – the net absorption for 2011 will be ca.

100,000 m<sup>2</sup> which will represent a 41% drop from 170,101 m<sup>2</sup> in 2010 and 64% decrease from the figure in 2009.

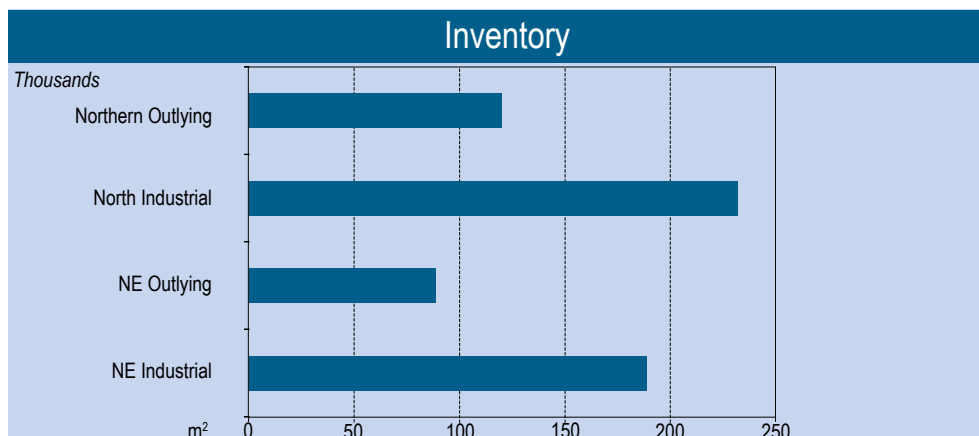
The industrial space market in Sofia is highly correlated with the consumer spending and the construction business. Both of these market drivers are stalling. Less than 20% of the industrial stock is occupied by manufacturing industries. Closed factories account for 37% of the vacant space in Sofia.

The trend is evident – manufacturing jobs are leaving the capital. Export oriented light manufacturing industries locate their facilities near secondary Bulgarian cities. The textile factories are leaving Bulgaria – they are going to the Far East in search of low labor cost jurisdictions.

The Baltic Dry Index was between 1,400 and 1,500 during the last quarter. These levels are above the 2008 historic bottom of 663. BDI is a very accurate barometer of the international trade since it shows the demand for ship space. The index collapsed from 11,000 to 850 from May 2008 to October 2008 and signaled the start of the economic recession of the world economy. The current figures are not optimistic and show that the economic activity is still depressed.

## Market Highlights

- The total industrial space stock in Sofia reached 2.097 million m<sup>2</sup> in Q2 2011
- Construction starts in Q2 2011 are 10,796 m<sup>2</sup>
- New deliveries in Q2 2011 are ca. 28,996 m<sup>2</sup>
- Prime rents are stable
- Vacancy rate increased slightly to 5.60% compared to 5.52% in Q1 2011
- Land market is still weak on the demand side



## Rental Rates

Prime rental rents remain at €4.00 – €4.30/ m<sup>2</sup> for modern warehouse space. The small units of 200-500 m<sup>2</sup> maintain slightly higher levels of €4.50 – €5.00 / m<sup>2</sup> per month.

Premium properties will not have problems finding tenants. Sofia Airport Center sets a brilliant example as the last vacant unit was rented out to Logwin. Subprime space will have trouble finding occupiers and landlords will have to offer deep discount of the rents in order to attract tenants in this challenging environment.

Interestingly a lot of landlords do not grasp the idea that they will face a lot of problems if the neighboring properties are foreclosed. When a bank repossesses a property, it could put it on the market for 60-70% of its construction cost, hence the new owner will be able to offer a 30-40% discount of the rental rates in order to retain or attract tenants. Leveraged landlords will not be able to compete with such a challenge unless they also restructure their debt.

## Vacancy

We witness a modest increase of the vacancy rate to 5.60% in Q2 2011. We estimate that the vacant space is ca. 117,430 m<sup>2</sup>.

The vacancy rate was 3.60% in Q4 2009 and it is creeping up every single quarter since the end of 2009. However, the industrial space market is quite stable in comparison to the retail and office space segments as the majority of the inventory

is owner occupied.

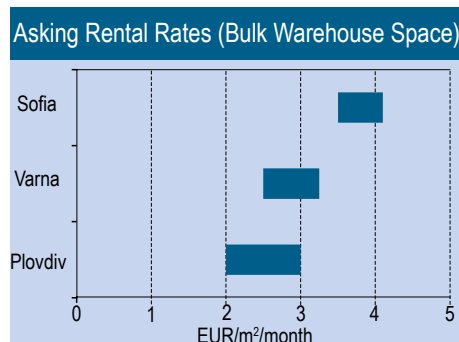
Developer-led speculative schemes account for 12.51% of the existing stock and speculative schemes under construction are 13% of the current pipeline.

## Land prices

We monitor a low activity on the land market generated mainly by the food retailers but even they are very cautious and careful when they review new opportunities.

Office developers are also careful and conservative when bidding for land plots. They factor in their prices the high vacancy rate in the office space market and the decreasing rental rates. They focus on the most liquid office space submarkets in the centre of Sofia, where the bid prices per TBA vary between €200 and €300 per m<sup>2</sup> for top locations. The asking prices are still at €400 – €500 per m<sup>2</sup> TBA.

Residential developers do not have spare cash to invest in land and prefer to negotiate compensation schemes. The land owners however are not happy with such offers since a lot of the construction



## Economic Highlights

- The GDP growth rate is positive for a fourth consecutive quarter at 1.5% as of Q1 2011, based on preliminary data by NSI. The IMF forecasts a 2.8–3% (y-o-y) GDP growth for 2011
- The inflation rate since the beginning of 2011 is 1.7% (based on CPI) while the y-o-y inflation (June 2010 – June 2011) is 4.8%, based on NSI data. The 12-month average inflation is 4.3%. The IMF forecasts an inflation rate of 5.3% for 2011
- Bulgarian National Bank has reported negative FDI flows in Bulgaria for the period January - May 2011 (€26.9 million based on preliminary data) as a result of the net payments on intercompany credits. The FDI flows for the same period in 2010 were €384 million, or 1.1% of GDP
- The Base Interest Rate was rather stable at 0.19% during Q1 2011, increasing to 0.22% in the second quarter and falling again to 0.17% as of July 2011. (BNB)
- The average unemployment rate in Bulgaria is gradually decreasing since the beginning of 2011. As of May 2011 it is 8.87%, down from 9.78% in January 2011. The IMF projects a further drop to 8% throughout 2011

companies are not able to finalize their projects.

The property flippers and speculators are gone. SMEs are buying industrial land plots but their size does not exceed 10,000 m<sup>2</sup>.

## Investment Activity

The commercial property market in Bulgaria enjoyed further improvement during Q2 2011. With investment activity being mostly retail-led, the trading volumes reached €120 million in the second quarter

and €160 million year-to-date. The sharp increase in transaction size during Q2 was due to the acquisition of Mall of Sofia by Europa Capital. The deal size was in excess of €100 million, making it the largest retail investment transaction in Bulgaria since 2008. Additionally, it was Europa Capital's second retail investment deal in Bulgaria after the €20-million acquisition of Retail Park Plovdiv in Q1 this year. In both transactions MBL | CBRE were the preferred advisor.

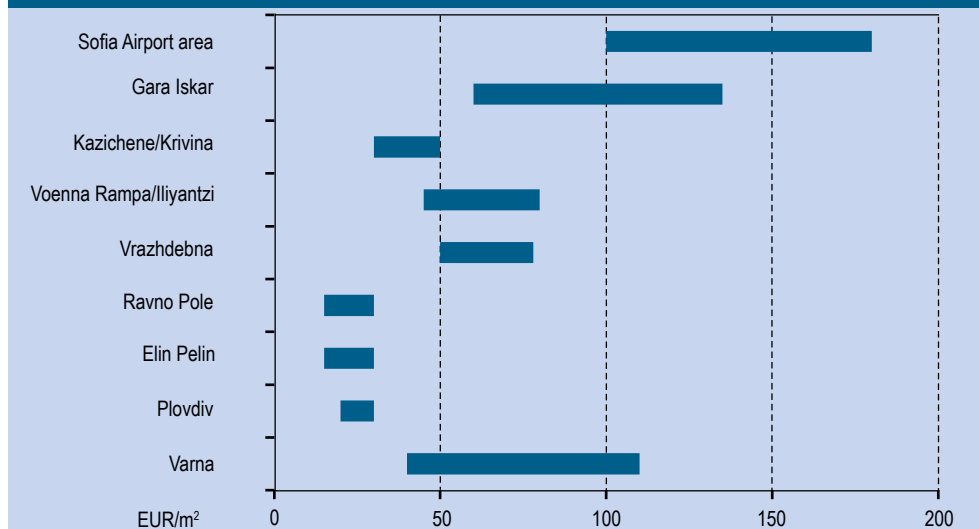
The prime yields changed little in Bulgaria over the last quarter. In terms of the yield gap between different asset classes, the

prime yield of 11.50% for industrial properties generally stood around 200-250 basis points higher than those for offices and shopping centers.

In Central and Eastern Europe (CEE), the overall trading volume reached €4.4 billion by the end of May 2011, representing an increase of 180% compared to the same period last year. The investment activity continued to rise across CEE markets, the focus still being primarily on Poland, the Czech Republic and Russia. Among the major CEE transactions were the sales of the Ritz Carlton Hotel and White Square BC in Moscow as well as the VGP portfolio in the Czech Republic. Further increase in CEE property investment volume is likely till the end of 2011, although the availability of quality product across the region may stand in the way of stronger growth.



### Price Range for Industrial Zoned Land (Selected Locations)



### Contact Information:

MBL  
24 Patriarh Evtimii Blvd.  
Sofia 1000, Bulgaria  
T: + 359 2 9888 650  
F: + 359 2 9876 191  
E: office@mbl.bg  
www.mbl.bg

Georgi Dimitrov  
Director  
Advisory Services and Valuations  
T: +359 2 9888 650  
F: +359 2 9876 191  
M: +359 886 292 081  
E: gdimitrov@mbl.bg

Hristo Asenov  
Director  
Land & Industrial Space  
T: +359 2 9888 650  
F: +359 2 9876 191  
M: +359 886 292 163  
Email: hasenov@mbl.bg

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